

VIA ELECTRONIC MAIL

February 27, 2009

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1500

RE: FINRA Regulatory Notice 08-08: Best Execution

Dear Ms. Asquith:

On December 16, 2008, the Financial Industry Regulatory Authority, Inc. (FINRA) requested comment on a proposal relating to FINRA's rule on best execution and interpositioning (Proposed Rule).¹ Adoption of the Proposed Rule would result in the following amendments to the existing best execution requirements:

1. The adoption of a new provision providing that a member firm has met its best execution obligations regarding orders for foreign securities with no U.S. market if certain conditions are met;
2. The replacement of NASD Rule 2320(g) with Supplementary Material addressing a member firm's best execution obligations when handling orders for securities with limited quotation information;
3. The codification of a member firm's obligation to regularly and rigorously review execution quality; and
4. The adoption of Supplementary Material addressing a member firm's obligations when handling an order that the customer has instructed the firm to route to a particular market for execution.

The Financial Services Institute² (FSI) commends FINRA for seeking industry comment on the Proposed Rule prior to submitting it to the SEC. In general, we support the Proposed Rule as a reasonable effort to merge the existing requirements of NASD Rule 2320³ and IM-2320⁴ into the FINRA rulebook. In addition, we note that the Proposed Rule simplifies and clarifies best execution and interpositioning requirements in several specific instances. However, we believe FINRA should take advantage of the opportunity presented by the rulebook consolidation process to enhance broker-dealer understanding of and compliance with the Proposed Rule by simplifying its language in certain provisions. Our specific comments are provided below.

¹ See the Proposed Rule and FINRA's request for comment in FINRA Regulatory Notice 08-80 at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117553.pdf>.

² The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 116 Broker-Dealer member firms that have more than 142,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 12,000 Financial Advisor members.

³ See NASD Rule 2320 at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=4320&element_id=3643&highlight=2320#r4320.

⁴ See NASD IM-2320 at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3644.

Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 98,000 independent financial advisors – or approximately 42.3% percent of all practicing registered representatives – operate in the IBD channel.⁵ These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.⁶ Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments

The following is a summary of FSI's specific comments on the Proposed Rule:

- Section 5310(d) – This subsection of the Proposed Rule incorporates the language of NASD Rule 2320(d) into the new rule. The subsection is intended to clarify the

⁵ Cerulli Associates Quantitative Update: Advisor Metrics 2007, Exhibit 2.04. Please note that this figure represents a subset of independent contractor financial advisors. In fact, more than 142,000 financial advisors are affiliated with FSI member firms. Cerulli Associates categorizes the majority of these additional advisors as part of the bank or insurance channel.

⁶ These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

application of the Proposed Rule's requirements in certain specific factual circumstances. We find the original subsection flawed in that its language fails to achieve the clarity and simplicity necessary for member firms to develop a reasonable degree of certainty that they are properly interpreting it. Therefore, we encourage FINRA to take advantage of the rulebook consolidation process to simplify the subsection's language by using clearly defined industry terms (e.g., clearing firm) throughout its provisions instead of the more complex and arcane descriptions (e.g., "third party pursuant to established correspondent relationships under which executions are confirmed directly to the member acting as agent for the customer") currently contained therein. We believe such changes will greatly enhance understanding of and compliance with the Proposed Rule's requirements.

- **Supplementary Material .04 Best Execution and Executing Brokers**—Supplementary Material .04 consists of modest edits to a portion of NASD IM-2320. The original Interpretative Memorandum was intended to offer clarification of a broker-dealers' best execution requirements in any transaction "for or with a customer of another broker-dealer". However, the original drafters were apparently unsatisfied with their first attempt to clarify the requirements and, therefore, attempted to clarify the clarification twice more (i.e., "Stated in another manner..." and "This clarification is intended to..."). Since the rulebook consolidation process provides an opportunity to improve member understanding of the Proposed Rule's requirements, we believe FINRA should take advantage by simplifying this unnecessarily complicated language in the Supplementary Material.
- **Supplementary Material .08 Regular and Rigorous Review of Execution Quality**—Subsection (c) of Supplementary Materials .08 provides guidance to introducing firms that route order flow to their clearing firm. This provision is of particular significance to FSI because the vast majority of IBD firms engage in this activity. We urge FINRA to eliminate the Supplementary Material's requirement that introducing firms periodically review the execution quality of orders placed through their clearing firm. Most IBD firms simply do not have sufficient expertise to perform a meaningful evaluation of their clearing firm's execution quality. As a result, the requirements of Supplementary Material .08 amount to a pro forma review process that establishes a regulatory hurdle without adding meaningfully to investor protection. Should FINRA choose to leave this requirement in place, we ask that they provide more guidance to introducing firms by establishing more specific review requirements. The Supplementary Material states that introducing firms can rely upon the clearing firm's "regular and rigorous review as long as the statistical results and rationale of the review are fully disclosed to the introducing firm and the introducing firm periodically reviews how the clearing or executing firm is conducting that review, as well as the results of that review." We urge FINRA to improve the rule by specifying the statistical results and rationale of review information that clearing firms must provide to introducing firms and the frequency with which such information must be reviewed by introducing firms.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to achieve additional clarity in the application of the best execution requirements.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dale Brown", written in a cursive style.

Dale E. Brown, CAE
President & CEO